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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1940

No. 699

GILBERT MOODY, JAMES H. JORDAN and WALTER J. SELBY,
Petitioners,

vs.

JAMES IRRIGATION DISTRICT, Debtor,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

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No.

GILBERT MOODY, JAMES H. JORDAN and WALTER J. SELBY,
Petitioners,

vs.

JAMES IRRIGATION DISTRICT, Debtor,
Respondent.

PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioners pray that a writ of certiorari issue to review the decision (R. 135) of the Circuit Court of Appeals for the Ninth Circuit made in the above entitled cause on September 5, 1940, which affirms the

interlocutory decree of the District Court for the Southern District of California, Northern Division, rendered against Petitioners on June 14, 1939. (R. 88.)

OPINIONS BELOW.

Opinion of Trial Court, 25 Fed. Sup. 974;

Opinion of the Circuit Court of Appeals, 114 Fed. (2d) 685.

JURISDICTION.

The decision of the Circuit Court of Appeals was rendered September 5, 1940. (R. 135.) A Petition for Rehearing was filed October 4th, 1940 (R. 136) and denied October 15, 1940. (R. 136.) The mandate was stayed until disposition of the case by this Court. (R. 136.) The Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code. (28 U.S.C., Paragraph 347(a).)

STATUTES INVOLVED.

Municipal Bankruptcy Act of May 24, 1934, c. 345 (48 Stat. 798) 11 U.S.C. 301-303, adding Sections 78-80 to the Bankruptcy Act of 1898; Act of August 16, 1937, c. 657 (50 Stat. 654) 11 U.S.C. 401-404, adding Sections 81-84; and Act of June 22, 1938, c. 575, Sec. 3(b) (52 Stat. 940). Principal

California statutes involved are "the California Irrigation District Act", Stat. 1897, P. 254 as amended; the "California Districts Securities Commission Act", Stat. 1931, P. 2263 as amended, and Stat. 1917, P. 243 as amended.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This is a proceeding brought by the respondent James Irrigation District, a California Irrigation District, for readjustment of its debts under what is now Chapter IX of the Bankruptcy Act of 1898, as amended. (11 U.S.C. Sec. 401-404.)

The matter came on before the court for hearing on November 28, 1938, on the Petition filed by the James Irrigation District, hereinafter called the district, on December 7, 1937, and the Answer and Objections to the Plan of Composition.

The district was organized February 6, 1920, pursuant to the California Irrigation District Act (Cal. Stats. 1897, P. 254, as amended), and has a gross area of 24,390 acres situated in Fresno County, California. (R. 5.) It issued general obligation coupon bonds in the amount of one million dollars May 16, 1920. All of these bonds were outstanding at the time of the hearing except five bonds of $1000 each. The plan of composition proposed disposition of these bonds as well as $21,954.75 of unpaid warrants. (R. 5, 6.)

Prior to the filing of the petition the district had acquired, pursuant to tax process, title to all of the

land within the district except 114.33 acres. (R. 19, 55, 77.)

17,630 acres of the land within this district is also within Reclamation District No. 1606 which was organized in 1914 under the provisions of the Political Code of California, and is also a public corporation. This Reclamation District had $445,000 in bonds outstanding which were secured by an assessment upon the lands within that Reclamation District. (R. 7.) This bond issue was also seriously in default and the County Treasurer had taken title to nearly all the land within the Reclamation District as trustee for the bondholders. Also the bulk of the land in the district had been sold and deeded to the State of California for non-payment of delinquent county taxes.

A settlement had been made with the county involved as to its tax title and the title of the county was acquired by the irrigation district at about the time of the hearing. (R. 19.)

The plan of composition offered a settlement of 24.976¢ for each dollar principal of the Irrigation District indebtedness but had a contingent provision requiring that the bonded indebtedness of the Reclamation District should also be settled and compromised out of the funds to be paid to the Irrigation District bondholders (R. 70-77), so that the net amount offered by the plan to the Irrigation District bondholders was 18.80¢ for each dollar of principal. The plan provided that the money to be paid to the Reclamation District should be paid to the Irrigation

District. This indebtedness has all been liquidated we contend and it is conceded that the title to all lands, except the 114.33 acres, is vested free and clear of encumbrance in the Irrigation District.

The bulk of the bonds of both districts were held by the James Land Corporation, which was a private corporation, and it was the principal and substantially sole creditor consenting to the plan of composition.

The money to be paid as provided by the plan of composition was obtained from a loan granted by the Reconstruction Finance Corporation, hereinafter referred to as the R.F.C., in the sum of $256,500. (R. 20.)

Only the petitioners resisted the plan of composition, and owned respectively, Moody, $3000, Jordan, $7000, Selby, $9000, principal amount of bonds. These creditors filed objections grounded upon the unfairness of the plan, contending amongst other things that the district owned all of its property in trust for the creditors and that purchasers of land will benefit unduly at the expense of the creditors; that the plan of composition has been executed, the debt readjusted to an amount of over 90 per cent of its former indebtedness, charging also lack of good faith, discrimination against the answering creditors; that the bonds of the James Land Corporation have been cancelled, surrendered; that the Bankruptcy Statute cannot be made to apply to this district and that the answering creditors were entitled to separate classification and are secured by certain trust funds.

Our view of the case.

A loan from the R.F.C. was obtained under the provisions of Tit. 43, Sec. 403, U.S.C., and disbursement was made on that loan after the filing of the bankruptcy petition prior to the hearing. The bonds of the accepting creditors were delivered by them to the R.F.C. after the petition was filed upon disbursal of the R.F.C. loan. The R.F.C. filed a claim on these bonds, stating that the R.F.C. "holds" the securities but did not state that it "owns" the securities. Now these bonds of course were for the most part those held by the James Land Corporation and the deputy treasurer of the district testified upon examination by the court and by counsel that none of the matured bonds or coupons held or owned by the James Land Corporation or the R.F.C. had ever been presented to the treasurer for payment since the year 1929 (R. 18), and he had no knowledge of the matter before that date. The R.F.C. claim set forth the face of all of the bonds and the matured coupons and did not make any claim that any of the matured bonds or coupons had ever been presented to the treasurer of the district for payment or that any of them had ever been registered as not paid for lack of funds. (R. 18.)

The importance of this point is that Sec. 52 of the California Irrigation District Act provides that the treasurer of the district must pay the matured claims against the district out of the bond funds in the order in what they are presented to him for payment.

Section 52 provides:

> "Upon presentation of any matured bond of the district, the treasurer shall pay the same from

the bond principal fund, and upon presentation of any matured interest coupon of any bond of the district, the treasurer shall pay the same from the bond interest fund. If money is not available in the fund designated for the payment of any such matured bond or interest coupon, it shall draw interest at the rate of seven per cent per annum from the date of its presentation for payment until notice is given that funds are available for its payment, and it shall be stamped and provision made for its payment as in the case of a warrant for the payment of which funds are not available on its presentation."

Cal. Stat. 1931, P. 172.

If funds are not available, the matured claims are registered by the treasurer and subsequently paid in the order of presentation. And the courts of California have so construed this section. (*Bates v. McHenry,* 123 Cal. App. 81; *Shouse v. Quinley,* 3 Cal. (2d) 357.) The only matured bonds and coupons which have been presented to the treasurer in accordance with Sec. 52 are Moody, $3260, Jordan, $3910, and Selby, $4600. (R. 14-17.) (See Court's Findings, R. 82-85.) In each case 7 per cent interest is payable on these amounts from day of presentation. The approximate total claims of the objecting creditors is $30,000. In the financial statement of the district for 1938 was an item of $30,000 under the heading of "Suspended Credits." (R. 53.) It was explained that this was an amount put on deposit in Federal Reserve Bank required by the 5th paragraph of petitioner's exhibit 19 which was a letter from the R.F.C. to the Bank relative to disbursal of the loan. (R. 53, 37.) Counsel

for the district stated that there was some correspondence and conversation about this matter in which it was suggested that in view of the fact that there were outstanding $30,000 in Irrigation District Bonds, a like amount in Reclamation District Bonds, that there should be "some guarantee that if the district had to meet these obligations there would be something on hand to meet them. The court and counsel for the district remarked that this was undoubtedly what the deposit was for." (R. 54.) The financial statement for 1938 showed the further item of a total of $68,890.66 in the funds of the district. (R. 54.) Of this amount, the item in the reserve fund and the bond fund totalling $12,597.30 and some portions of the general funds are trust funds belonging to the petitioners, who have presented their claims and are next in line for payment. (Findings, R. 85.)

The petitioners contend that they are entitled to separate classification as to those claims which were presented to the treasurer and by the treasurer stamped and registered. This case is peculiar in that out of a bonded indebtedness of over a million dollars, of which a half million has already matured, with a further half million in defaulted interest coupons (R. 55), a portion of the claim of the petitioners amounting to approximately $11,770 plus interest thereon, is entitled to separate classification by reason of having been presented to the treasurer of the district for payment in accordance with the provisions of the California law on the subject. It is the contention of these petitioners that the $30,000 deposited with the R.F.C. as well as something over $12,579.30

of moneys in the bond funds, and other funds, constitute trust funds which cannot be applied pro rata until the preferred claims of the petitioners have been paid in full with 7 per cent interest. If the plan is otherwise fair, if our other contentions are not good, then the plan might be confirmed upon condition that these preferred claims of the petitioners amounting to $11,770 plus interest at 7 per cent be paid in full.

The "Plan" required the bondholders to pay to the district enough money to acquire all the reclamation bonds. (R. 8, 9.) The R.F.C. therefore holds these bonds in trust for the district. The original creditors consisting chiefly of the James Land Corporation and A. L. Cowell retained no interest in the bonds upon the transfer of their bonds to the R.F.C.

In this case the district has acquired marketable title to all the land of the district (except a minuscule of 114.33 acres, possibly held by the directors to give them a legal position as district directors). Since this district is a state agency and the property is the property of the state (*El Camino Irrigation District v. El Camino Land Corporation,* 12 Cal. (2d) 378), it seems apparent that the state is not only the owner of the assets but also becomes in a peculiar sense the debtor on the bonds.

Under California law the new refunding bond issue cannot be issued except that bond issue be less than 60 per cent of the value of the bare land in the district plus the district's works.

> "Sec. 4. * * * No bond issue of any district shall be approved for certification as provided in this act which together with any other outstanding

> bonds of such district including bonds authorized but not sold exceeds sixty per centum of the aggregate value of the water, water rights, canals, reservoirs, reservoir sites, irrigation and power works and other property owned by the district or to be acquired or constructed with proceeds of the bonds proposed to be issued by said district, and the reasonable value of the lands within the boundary of the district."
>
> *Cal. Stat.* 1931, P. 2263.

Therefore, there is a beneficial interest in the land equal at least to 40 per cent of the value of the district's assets. That land is not offered to the bondholders. It does not seem that it could be taken from them under the guise of a bankruptcy proceeding. It does not appear either that the bankruptcy statute can apply to the state, as the state owns all of the assets and is in substance the debtor.

Petitioners in this case do not contend that if the land were owned by private land owners, those landowners could reasonably be expected to pay the entire debt of the district. But they do contend that the State of California cannot thus repudiate its own obligation as maker of the bonds and owner of the lands. We further contend that in no event can the creditors be deprived of the equitable interest in the land over and above the R.F.C. loan; further, that petitioners' preferred claims must be paid in full.

QUESTIONS PRESENTED.

1. When the local law provides that the obligations of the district shall be paid in the order of their presentation to the treasurer after maturity and the petitioners are the only creditors who ever presented any of their matured claims to the treasurer and they have made proof of their claims and the bankruptcy court so finds, are such claims given a "preference as provided by law" as defined in the statute, and must they be separately classified?

2. Where the district owns all the land and it has been cleared of other tax liens and obligations and the local law provides that it cannot borrow more than 60 per cent of the value of the bare land, without improvements, plus the value of the works of the district, and the plan of composition only offers to the bondholders the amount which it can thus borrow, as a matter of law can such a plan be fair, and should not the plan to be fair give to the bondholders not only what the district can borrow but the land itself?

3. Where under local law it has been determined that all of the functions of bankrupt are exclusively governmental, can an interlocutory decree be valid which applies to such a district?

4. Where the local law determines that the assets of the district are state property and the bonds which are the subject of the composition plan are issued by the state, although payable solely by the district out of its assets, can the state consent to a plan of composition which will thus terminate its (limited) liability?

5. May not the State be prohibited by its own Constitution from consenting to bankruptcy relief? Do provisions against surrender of taxing power, impair-

ment of contracts, delegation of judicial authority, confiscation of private property prohibit such consent?

6. Where a corporation creditor owning over 90 per cent of the district's bonds consents to the plan, and the R.F.C. has paid off that corporation at the composition rate, has not the indebtedness of the district been thereby reduced automatically, in view of Title 43, sec. 403, U.S.C., providing that the R.F.C. cannot make a loan unless it is satisfied that such loan will result in a substantial reduction of the indebtedness of the district?

REASONS FOR GRANTING WRIT OF CERTIORARI.

(1) The law of California provides, we contend, that the matured claims of a California irrigation district must be paid in the order in which they are presented to the treasurer of the district, stamped and registered by him. In this case, the only claims which were ever so presented and stamped are approximately $11,770 in claims of the petitioners out of a total indebtedness of over a million dollars. We contend, therefore, that the court below erred in holding that this is not a "preference" provided by law as defined in Chapter IX of the Bankruptcy Act, and erred in holding that the Bankruptcy Law supersedes the local law on this question; and erred in holding that because a recognition of this local law might upset or interfere with some bankruptcy plan if applied, such a law should not be applied in a bankruptcy court. This is a question which may come before courts many times; is one of importance, and this Court should

grant a review of this case in order to set at rest the question of construction of the term "preference" in the application of the municipal bankruptcy law.

2. When the local law provides that bonds cannot be issued against the lands of the district in excess of 60 per cent of the value of the bare lands (without improvements) and of the works of the district, this Court should determine, as we contend, that as a matter of law a plan of composition is not fair which only offers the amount which can be obtained by such a loan.

3. Where, as here, the district owns all the land, the plan should offer the land to the bondholder, the creditor, as well the amount it can obtain from the R.F.C. upon such a restricted loan. We contend that in considering a plan of composition under the municipal bankruptcy law, the principles confirmed in *Case v. Los Angeles Lumber Products Company,* 308 U. S. 106, must be applied to a public agency, and this Court should so determine, and this is a matter of administration of the act which should be settled by this Court.

4. Where the district owns all the land and it is determined by state law that such land becomes state property, this Court should determine, as we contend, that the state can not give its consent to the bankruptcy plan where it thus becomes not only the debtor but the creditor? This is a matter of great public importance because of the effect of such a determination upon matters of public law, as affecting the question of dual sovereignty.

5. Where as here property is held in a public trust we contend the bankruptcy power can not be applied to such trust and this Court should so determine.

6. Where the R.F.C. has paid off the principal consenting creditor, the plan is an executed plan. The creditor has surrendered his claims. The R.F.C. was authorized by its basic charter (43 U.S.C. 403) to loan, if satisfied that a substantial reduction is thereby effected in the district's debt. We contend the plan then becomes executed as to such creditor and that this Court should so determine.

Wherefore, petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and to send to this Court for its review and determination a full and complete transcript of the record and of the proceedings of said Court in the case numbered and entitled in its dockets as "No. 9353, Gilbert Moody, James H. Jordan and Walter J. Selby, Appellants, vs. James Irrigation District, Debtor, Appellee", and that the decree of said Court be reversed by this Court with directions to dismiss the bill, and for such other relief as to this Court may seem proper.

Dated, Turlock, California,
January 6, 1941.

GILBERT MOODY,
JAMES H. JORDAN,
WALTER J. SELBY,
Petitioners.

W. COBURN COOK,
Counsel for Petitioners.

In the Supreme Court
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No.

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Petitioners,

vs.

JAMES IRRIGATION DISTRICT, Debtor,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. FACTUAL BACKGROUND OF THE CASE.

Some of the facts are stated under the heading Summary Statement of the Matter Involved, in the accompanying petition. There is also a statement of some of the facts in the opinion of the court below. (*In re James Irr. District,* 25 Fed. Sup. 974.) This case was heard in the Circuit Court of Appeals upon an agreed statement of the case. (R. 2.)

The James Irrigation District was organized February 6, 1920, under the California Irrigation District

Act, and contained an area of 24,390 acres situate in Fresno County, California. In 1920 it issued a million dollars in bonds in the denomination of $1000, of which $995,000 are involved in these proceedings, together with $21,954.75 of warrants. A considerable amount had matured. The District also overlapped Reclamation District 1606 which is likewise a public corporation, organized under the provisions of the Political Code of California. The plan of composition offers 24.976¢ on each dollar principal, with nothing for interest, and provides further that bondholders accepting the plan must turn in with their own bonds a proportionate amount of the bonds of the Reclamation District. The Reclamation District had outstanding $445,000 in bonds secured by an assessment on the lands within that district. These two districts largely overlap. Where an irrigation district bondholder did not have a bond to turn in, he was required to pay to the irrigation district a certain sum in cash with which to acquire a proportionate amount of reclamation bonds he did not own, so that the net amount offered to the irrigation district bondholder in the composition plan was $188.80 per thousand dollar bond.

The bankruptcy petition was filed December 7, 1937. It was shown that on October 30, 1937, the James Land Corporation owned bonds of the irrigation district in the total principal amount of $944,000, and all of the outstanding warrants except $28.36, and that A. L. Cowell owned bonds of the district in the amount of $21,000. These bonds and warrants were turned in in acceptance of the plan.

The only non-consenting and objecting creditors were the petitioners who own $19,000 of the principal amount of bonds. In their answer they claim this amount with interest represented by the coupons and also with interest as provided by Section 52 of the California Irrigation District Act. These objecting creditors filed claims in which they set forth the dates of maturities and dates of presentation of their claims to the treasurer of the district. Section 52 of the California Irrigation District Act provides:

> "Upon presentation of any matured bond of the district, the treasurer shall pay the same from the bond principal fund, and upon presentation of any matured interest coupon of any bond of the district, the treasurer shall pay the same from the bond interest fund. If money is not available in the fund designated for the payment of any such matured bond or interest coupon, it shall draw interest at the rate of seven per cent per annum from the date of its presentation for payment until notice is given that funds are available for its payment, and it shall be stamped and provision made for its payment as in the case of a warrant for the payment of which funds are not available on its presentation."
>
> Cal. Stats. 1931, p. 172 as amended.

It is contended by the petitioners that this act as construed by the California courts creates a "preference by law" in favor of the matured claims which have been so presented and registered. The answers and claims of the petitioners showed that the total amount of $11,770 of then matured bonds and coupons had been presented to the treasurer of the district for

payment and registered pursuant to this act. (R. 14-17.)

Subsequent to the filing of the bankruptcy petition the consenting creditors transferred their interests to the R.F.C. and that corporation filed a claim, but none of the matured claims had ever been presented to the treasurer for payment at least since the year 1929. The treasurer could not say of his knowledge what occurred before then but evidently they never had been presented, since the R.F.C. did not in its verified claim make any claim that any of the matured bonds had ever been presented to the treasurer or had ever been registered (R. 18) and the district's records disclosed no such presentation. (Findings, R. 84.) This, although $545,000 of bonds and $510,000 of coupons had matured and were unpaid at the time of the hearing. (R. 70.)

All of the land within the district except approximately 120 acres is owned by the district. (R. 19.) The same land had been sold to the state for delinquent taxes but on December 27, 1937, the district purchased the state's title for $54,000 which was about 17¢ on the dollar of delinquent taxes. (R. 19.) The district quieted title to the land (R. 19) and of course has acquired the interest of the Reclamation District through the composition plan, and the payments made to it out of the moneys received from the James Land Corporation and A. L. Cowell, so that the title to the property is free and clear in the district except the 120 acres referred to.

The district has assessed the value of its land for taxation purposes at $967,450 (R. 19) and entered into contracts to sell most of its land but the payments have not been completed and under California law these sales are subject to the bonded indebtedness.

Provident Land Corporation v. Zumwalt, 12 Cal. (2d) 365.

The district applied to the R.F.C. for a loan in 1935 under provisions of Section 36 of the Emergency Farm Mortgage Act, being Title 43, Section 403, U.S.C. The loan provided that refunding bonds should be issued in the amount of $256,500 to be sold to the corporation. The contract with the R.F.C. provided that no disbursement would be made until at least 90 per cent of the securities had been deposited and provided for a scale of payment to the bondholders depending upon the amount of bonds deposited. (R. 20, 22.) The contract also provided that no disbursement would be made by the R.F.C. until the borrower (that is the district) had complied with the general conditions set forth. It also provided certain special conditions, one of which was that substantially all of the land should be placed in private ownership, another that the bonded indebtedness of the Reclamation District should be cancelled, the property relieved of delinquent taxes, and no contracts of the land sales made without approval of the R.F.C. (R. 23-24.)

Petitioner's claims amounted to $29,830 principal and coupons, plus interest as provided in Sec. 52. (Findings, R. 82-84.)

The R.F.C., before it made its disbursements, required that the district should deposit $30,000 (R. 40), an item called "Extended Credits". This was interpreted by the court and by counsel for the district as a "guarantee" that there would be funds to pay the outstanding undeposited bonds. (R. 54.) This procedure for the liquidation of the James Land Corporation (and Cowell's) interests and the deposit of the "guarantee", carried out without any court authorization would seem to consummate the plan extrajudicially.

An election was held by the people living in the district (R. 42) at which the proposition voted upon was whether the district should enter into the contract with the R.F.C. to issue refunding bonds in the amount of $256,500 for the purpose of reducing the indebtedness of the district (R. 43), pursuant to the provisions of California Statutes 1917, page 243, as amended, of which Section 3 provides:

> "Any proposal to enter into a contract with the United States for the repayment of construction moneys, the cost of a water supply or the acquisition of property, and to issue bonds, if any be proposed, shall be voted upon at an election wherein proceedings shall be had in so far as applicable in the manner provided in the case of the ordinary issuance of district bonds."

The California Districts Securities Commission, having authority over the financial affairs of this district in the matter of the issuance of bonds under the provisions of California Statutes 1917, page 243, as amended, and California Statutes 1931, page 2263, as

amended, made an order approving the issuance of the bonds. (R. 44.) This commission, also, on September 17, 1937, made an order validating the refunding bonds (R. 47) as provided by the California Districts Securities Commission Act (Cal. Stats. 1931, p. 2263, as amended) in which this commission determined (R. 49):

> "That the reasonable value of the water, water rights, canals, reservoirs, reservoir sites, irrigation works and other property owned by the district is estimated in excess of the sum of $1,000,000; that the reasonable value of the lands within the boundaries of said district is estimated to be in excess of $960,000;
>
> "That the $256,500 par value of refunding bonds under consideration, including bonds authorized but not sold, does not exceed sixty (60) per centum of the aggregate value of the water, water rights, canals, reservoirs, reservoir sites, irrigation works and other property owned by the district, and the reasonable value of the lands within the boundaries of the district."

This report and finding was signed by the commission including H. E. Vogel who was a principal witness for the district at their bankruptcy hearing and his testimony is referred to by the court below as substantiating the bankruptcy plan. In spite of Vogel's concurrence in the above finding, yet he testified that "he thought that the indebtedness of $256,500 provided in the plan of composition was well up to the limit of the ability of the lands in the District to meet". (R. 64.) On the same page of the record appeared his statement that if the value of the land

was to be determined from the annual income it would be practically nil, but as a speculative value it would be only a guess. Annual income is not the sole evidence of value, and ability to pay is not the gauge of the state's power of taxation.

The evidence showed that the R.F.C. was paid interest at 4% on the amounts disbursed from and after December 28, 1937, the date of disbursement.

The district's financial statement showed $68,886.56 on hand (Court's Findings, R. 85), of which $12,597.30 is in bond funds and reserve fund, the reserve fund being in effect a bond fund. It is also shown that some portion of the general fund was derived from assessments, water tolls, sales of property, and possibly some land rentals.

There had been a general default in the payment of assessments since 1926. The district took deeds to the property and cleared the titles. (R. 55.) The secretary of the district testified that the crash of the district was caused by the fact that one corporation owned over half the lands in the district and because of financial difficulties it was unable to keep up its assessments and the others soon defaulted. (R. 56.)

The amount provided to be paid each bondholder is $188.80 per thousand dollar bond, including interest from October 31, 1935, to the date of the first disbursement, December 27, 1937. (R. 80.)

II. THE CLAIMS WERE NOT PROPERLY CLASSIFIED.

Petitioners Moody, Jordan and Selby owned bonds in the amount of $19,000, which, with the accompanying interest coupons amount to approximately $30,000, and in addition interest at 7 per cent per annum as provided by Section 52 of the California Irrigation District Act upon $11,770 of matured bonds and interest coupons which were presented to the treasurer for payment and registered, from the date of such registration.

In this respect these claims differ from the claim of the R.F.C. in that the R.F.C.'s bonds were not presented to the treasurer and there is no 7 per cent interest on the matured bonds or coupons.

However, it is in respect of the presentation of the matured bonds and coupons amounting to $11,700 of the petitioners to the treasurer and their registration by the treasurer under the provisions of said Section 52 that the petitioners claim that they are entitled to separate classification.

Section 83(b) of the Bankruptcy Act provides in part:

> "* * * the judge shall classify the creditors according to the nature of their respective claims and interests: Provided, however: That the holders of all claims, regardless of the manner in which they are evidenced, and which are payable without preference out of funds derived from the same source or sources shall be of one class. The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as pro-

vided by law, shall accordingly constitute a separate class or classes of creditors."

Section 52 of the California Irrigation District Act as construed by the courts of California consistently, provides, we contend, such a preference.

Bates v. McHenry, 123 Cal. App. 81, is the leading case. The court said:

> "Again, the treasurer of the district has authority to perform two acts: He must either pay the bond or interest coupon when presented, or register the same. The irrigation laws do not confer upon the treasurer of the district any authority to pro rate payments. If the money is there and the bond or interest coupon is due, his legal duty is to pay. If money is not there, his legal duty is to register the bond and interest coupon and make payment, with the added interest, as soon as sufficient money is available."

In the case of *Shouse v. Quinley,* 3 Cal. (2d) 357, the Supreme Court of California held a section of the Irrigation Act unconstitutional and said:

> "By the general terms of the act, the bondholder had the right to have his bonds paid upon presentation if money were available and if not to have them registered and paid in the order of presentation."

In the case of *El Camino Irrigation District v. El Camino Land Corporation,* 12 Cal. (2d) 378, the Supreme Court of California said:

> "to permit successful judgment creditors, whose bonds may not be prior in registration, to be paid

by the proceeds of execution sales, would result in an unjustified preference. * * *"

and said further:

"* * * the procedure, unless restricted in some manner unknown to us, would operate to violate the rules of priority established by the decisions in this state. Bates v. McHenry, * * *"

In *Selby vs. Oakdale Irrigation District,* 140 Cal. App 171, the Court of Appeal reaffirmed this position, and in *Rohwer v. Gibson,* 126 Cal. App. 707, the court said:

"It is further provided in the California Irrigation District laws that unpaid registered interest coupons shall be paid in the order of their registration;"

We should point out that in the case of *Clough v. Baber,* 100 C. A. D. 946, 100 Pac. (2d) 519, the Third District Court of Appeal (not the highest court in California) sought to distinguish the facts of the particular case before the court, where the plaintiff sought payment of his $5000 of bonds out of $15,000 the district had. The court said:

"In the present case the district is insolvent; the lands have all been conveyed to the state on account of default of assessments; matured bonds in the aggregate sum of $283,000 are unpaid, many of which have been registered subsequent to petitioner's bonds; the rented lands fail to produce sufficient income to pay operating expenses and accruing interest to meet the debts of the district; the taxing power of the district

> has been entirely exhausted; there is no prospect of raising further funds in any manner whatever, with which to meet the present and future obligations of the district. Under such circumstances the petitioner is not entitled to payment in full of his five registered bonds as a preference, but the available funds should be apportioned pro rata among the holders of all valid claims."

Petitioners point out that where the highest court of the state has determined the law, the bankruptcy court should follow it. That court should determine from the statutes and decisions what the local law is. Here we have ample authority from the California Supreme Court.

The California rule is, we contend, propositions of law laid down in a decision of a District Court of Appeal, do not become expressions of opinion of the California Supreme Court, even where a transfer of the case to the Supreme Court is denied. (*People v. Davis,* 147 Cal. 346.)

If the decision in the *Clough v. Baber* case, supra, were the only decision, the bankruptcy court would be bound by it, though it is the decision of an intermediary court. But where there are decisions of the highest court of the state, those decisions should be looked to for interpretation of the local law. (*West v. American Tel. & Tel. Co.,* .....U.S....., 61 S. Ct. 179; *Fidelity Union Trust Co. v. Field,* .....U.S....., 61 S. Ct. 176; *Six Companies of California v. Joint Highway Dist.,* .....U.S....., 61 S. Ct. 186.)

In the following case decided in 1938 by the Supreme Court of California in a group of four cases in which the districts owned substantially all the land and there were practically no landowners left and the districts were heavily in default on their bond debt, the court discussed the economic situation as affecting bondholders' rights at considerable length and declared:

> "* * * "two things should be clear: first, that this money should go to the bondholders; and second, that in any event it should not be given to junior bondholders in preference to those with prior claims but should be paid on past due bonds and coupons in the order of their presentation."
>
> *Provident Land Corporation v. Zumwalt,* 85 Pac. (2d) 116, 12 Cal. (2d) 365.

The court below said (114 Fed. (2d) 685):

> "But we decided in the Merced case that due bond interest and principal does not become preferred claims when presented and registered as provided by Section 52 of the California Irrigation District Act. Had the District proceeded in its course as a solvent entity, the holders of overdue bonds and interest would have been paid in accordance with Section 61 (a) of the California Irrigation District Act. But it did not and could not have so proceeded and it resorted to the Bankruptcy Law for relief."

In the Merced case, *West Coast Life Insurance Co. v. Merced Irrigation District,* 114 Fed. (2d) 654, the court had said:

> "We are convinced that appellants have erred in their reasoning that the registration gives a

> preference by law to the due but unpaid obligations that is different in any manner from the obligation of the bond contract as to due dates."

The court below seems to suggest in the Merced case that the Section 52 is simply for the purpose of arranging an orderly machinery for notification when funds become insufficient to meet the delinquencies and then gives another reason for that court's position that appellant's theory was erroneous, namely, "that the power of Congress in the field of bankruptcy * * * is both unlimited and supreme is not questioned". *Sturges v. Crowninshield,* 4 Wheat. 122, 192, 4 L. Ed. 529. Rights "* * * must be decided by the Bankruptcy Act, since it is superior to all state laws upon the subject." *Moore v. Bay,* 284 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133, 76 A. L. R. 1198; *New York v. Irving Trust Co.,* 288 U. S. 329, 53 S. Ct. 389, 77 L. Ed. 815. "We find nothing in the act justifying the classification suggested by appellants." (114 Fed. (2d) 654, at page 673.)

In *Ginsberg v. Lindel,* 107 Fed. (2d) 721, 725, 726, the court said:

> "Legislation by Congress may supersede that of a state in a particular instance, but Congress can not repeal a state law; nor can it exert control over individual property rights except in the proper exercise of its constitutional powers."

and said further:

> "There is, however, a significant difference between a property interest and a contract, Kuehner v. Irving Trust Co., supra, and the ex-

ercise of these powers does not permit the total or partial destruction of vested property rights. Due process of law 'inhibits the taking of one man's property and giving it to another, contrary to settled usages and modes of procedure, and without notice or an opportunity for a hearing.' Ochoa v. Hernandez, 230 U. S. 139, 141, 33 S. Ct. 1033, 1041, 57 L. Ed. 1427. Congress, in the exercise of the bankruptcy power, is bound by this principle and may not take a property right from one creditor and transfer it without compensation to another without violating the Fifth Amendment. Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 601, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106."

The petitioners contend that the court below has decided this important question of local law in a way in conflict with applicable local decisions and that the application of these local decisions on this question in the administration of the bankruptcy law under Chapter IX of the Bankruptcy Act is an important question of federal law which has not but should be settled by this court. Petitioners also contend that the Circuit Courts conflict in their opinions as just shown.

It is the contention of the petitioners not only that these claims have a preference provided by law but also that they are in effect secured by trust funds and properties.

La Forge v. McGee, 6 Cal. 650.

In *McKaig v. Moutrey,* 32 Cal. App. (2d) 537, 90 Pac. (2d) 108, the court said:

> "the assessment when so levied, became the property of the district and was held in trust for the bondholders under Section 29 of the Irrigation District Act."

People v. Bond, 10 Cal. 563-573, where the court held that moneys collected by the treasurer "stands as a trust fund which the treasurer, as the bailee of this sum, is to pay the commissioners". See also

Ecker v. S. W. Tampa Storm Sewer Drainage Dist. 75 Fed. (2d) 870, 872;

Hidalgo County Road Dist. v. Morey, 74 Fed. (2d) 101;

River Farms Co. of Calif. v. Gibson, 4 Cal. App. (2d) 731.

In the case of *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 Pac. (2d) 116 at 120, the court said:

> "the lands remain in trust, and the district exercises its powers, however broad, as a trustee. Once it is made clear that the lands are held in trust, it necessarily follows that their proceeds, whether by sale or lease, are likewise subject to the trust."

We respectfully submit that $11,770 of the claims of the petitioners, with 7 per cent interest from the respective dates of presentation to the treasurer, are entitled to classification as a separate class and the plan should only have been confirmed upon condition that such classification be recognized and that these obligations be paid in full out of the trust funds consisting of bond fund moneys, $12,597.30, the $30,000

deposited with the R.F.C., as a guarantee against liability for this payment, and out of other trust fund properties, including rentals. If the plan be otherwise confirmed then this condition of confirmation should be decreed, and the balance of petitioners' claim would be paid pro rata in the same manner as other claims against the district.

III. THE DISTRICT IS A TRUSTEE FOR THE BONDHOLDERS.

We have already shown under the foregoing head that all the property of the district is held in trust for the uses and purposes of the act. This position was thoroughly expounded in the case of *Provident Land Corporation v. Zumwalt,* supra, where it is held that the directors of the district might take out sufficient funds to pay the operating expenses of the district and after having done so the remainder of the fund which should be accumulated as a surplus, should be paid to the bondholders in the order of presentation of their claims.

In this particular case the district has taken title to the land in the district. It has proceeded to compromise with the county the tax delinquencies against the land. Funds made available by the R.F.C. and paid to the district by the bondholders who turned in their bonds to the R.F.C. enabled the district to liquidate the indebtedness of the Reclamation District. It therefore holds this land in trust, free and clear of all encumbrance, and the Supreme Court of California has lately held in an important decision that an

irrigation district holding title to land under these circumstances holds it free and clear of the power of taxation of the county or other public agencies. (*Anderson-Cottonwood Irr. Dist. v. Klukkert,* 13 Cal. (2d) 191.)

Therefore, the sole beneficiary of that trust, after taking out operation costs, is the payment of the indebtedness of this district. Why, then, should this trustee go to the R.F.C., borrow money from that corporation, and attempt to liquidate its obligations under this trust by the payment only of the amount it can borrow from the R.F.C.? And what social necessity, or what national or state program requires that this land, which is owned by this public agency in trust to pay these bonds should be taken from these bondholders? Inasmuch as this district would not have to pay taxes upon this land as long as it holds the land, would not the bondholders be in a much better position if the district retained the title to the land, leased it out to farmers, free and clear of the liability to pay any taxes whatever, and devoted the proceeds of those rentals toward the liquidation of the indebtedness of the district so far as it would go? In this manner the bondholders would be in a position to benefit from the possibility of future increment over and above the amount of the present borrowing from the R.F.C., and would of course benefit by the increased revenue which would come by way of rentals. The district is able to collect for its treasury the *full rental value* of the land without any obligation to surrender any portion thereof to a county or any other taxing authority in taxes.

The rental value of the land pledged as security is equivalent to a first lien on all of the property of the district. To permit any portion of this rental value to accrue to private interests as it would if this plan is confirmed or to the State of California, is tantamount to allowing a second mortgage to be paid while the first mortgage is ordered drastically scaled down. These bonds of course are general obligation bonds, payable by unlimited taxes, according to land values, not according to "ability to pay".

Roberts v. Richland Irr. Dist., 289 U. S. 71;
Rialto v. Stowell Irr. Dist., 246 Fed. 294;
Farwell v. San Jacinto Irr. Dist., 49 Cal. App. 179;
Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365.

In *Judith Basin Irrigation Dist. v. Malott*, 73 Fed. (2d) 142, the court says:

> "It has been uniformly held that bonds of an irrigation district issued in pursuance to the Wright Act * * * are general obligations of the district."

and further:

> "The payment of the bonds at earliest maturity does not release any parcel of the land from the lien of the bond, and all the land within the district, according to the terms of the bond and of the statute are liable for the payment of the unpaid bonds."

Should the bankruptcy court apply the "ability to pay" yardstick, when the state has adopted a different yardstick in its taxation system?

The court below seems to have ruled that when the rental value or usufruct of land is pledged to the State, as here, and that security is pledged by the State, through its Governmental Instrumentality, for money borrowed to finance the cost of State owned permanent public improvements, the State can "consent" to repudiate its contract, for the benefit of non-creditors.

Is landlordism subject to the Bankruptcy clause, only when as here it is the State that is the landlord?

In more than one other California Irrigation District, full and complete title to all the land is and has been vested in the District for years. That fact however has not caused any district to "collapse" any more than had private mortgagees foreclosed the same land.

The concern expressed in the Ashton minority opinion, to the effect that failure to approve a petition would result in all parties being "caught in a vise" is wholly inapplicable under California law.

The district title to tax reverted land is free and clear of all mortgages or other private liens formerly on the land, including any mortgages securing Federal Land Bank bonds.

If the land in the district should prove to be without a rental value, those who invested in the bonds would obviously never get paid. But no scale down of the bonds will improve or increase the rental value of the land. Whether this rental value, present or

future is much or little, it is pledged as a public trust and made by law the exclusive property of the irrigation district, dedicated to any degree or extent necessary to meet the district's costs of operation and lawful debts when, as and if funds are available.

Are the rights of the state to the rental value of land pledged for security for money borrowed by its agency any more subject to control by a court of bankruptcy than rent promised to a private landlord? Our courts uphold the doctrine that it is illegal for a bankruptcy court to require a private landlord to continue a lease in effect for rent less than that stipulated in the contract. By confirming the plan here, the court in effect made it legal to compel the holders of these bonds to surrender a part of their right to the rental value of these lands, and this for the benefit of the state, in spite of the fact that our courts have held that it is the duty of the county to keep lands on the paying tax roll, even to the extent of discharging other public obligations.

County of San Diego v. Hammond, 6 Cal. (2d) 709;

County of L. A. v. Jones, 6 Cal. (2d) 695.

It matters not whether the rental value of land in a California Irrigation District be much or little. Whatever it is or may become, it is the exclusive property of the district, and is in effect dedicated to the public trust to any degree or extent necessary to meet the costs of operation and the debts of the district. (*Provident Land Corp. v. Zumwalt,* supra.) If the land has no rental value the bonds will never be paid,

and no bondholder would be allowed to sue the state. No user of land could be compelled to pay more than the actual economic rent, that is, no more than he would have to pay a private landlord. Whether this rent is paid to a private landlord or to a state agency matters not to the user of lands. It is only as private interests are enabled to appropriate the ground rent which they believe they can charge users of land that land acquires a so-called market value. The only effect of denying the petition of the district for relief will be to keep the land prices from rising as high as they otherwise would, for the district could rent the land on a cheaper basis than it can sell it.

IV. THE PLAN IS NOT FAIR NOR EQUITABLE.

The plan is not fair for the following reasons:

1. It does not classify the petitioners' preferred claims separately.

2. It does not give to the bondholders the full benefit of the value of the assets of the district. In the first place it merely gives them what it can borrow from a banker, and that, as we have shown, is not in excess of 60 per cent of the value of land and works of the district. Second we have shown in the last preceding subject head that the district is seeking to take from these bondholders a possible future benefit or future value.

Finally, we contend that the plan is not fair because it has been in effect executed and carried out and the consenting bondholders have surrendered and cancelled

their claims against the district in favor of the district. When these bonds were surrendered the case became moot.

V. CHAPTER IX OF THE BANKRUPTCY ACT CAN NOT EXTEND TO THIS DISTRICT NOR CAN THE STATE CONSENT TO SUBJECTING THIS DISTRICT TO THE BANKRUPTCY PLAN.

We contend that since the Supreme Court of California has held that all of the functions of the California irrigation districts are governmental, that the Bankruptcy Act cannot extend to a California irrigation district. These decisions having come down from the California Supreme Court, and the law having become definite after the decision in *U. S. v. Bekins,* 304 U. S. 27, 82 L. ed. 1137, this Court should reexamine this issue in order to determine whether or not the Bankruptcy Act can apply at all to such a district under our constitution.

Risty v. Chicago R. I. & P. R. Co., 270 U. S. 378;

Chicago M. St. P. & P. R. Co. v. Risty, 276 U. S. 567.

It is also our contention that the James Irrigation District stands in a different position than the public agencies in some of the other cases whose composition plans have come before the court. Here, the district has acquired title to all of the land except a mere fraction. These bonds were issued by the State of California and bear its seal and are made payable by a state agency out of the resources and power of assessment delegated to that state agency. They are

therefore in legal effect obligations of the State of California, limited as to the source of payment. The state could legally pay these bonds, or it could permit the county to pay them.

County of L. A. v. Jones, supra;
County of San Diego v. Hammond, supra.

They are state obligations.

In another sense they are the obligations of the landowners, within the district, for such a bond is in effect a contract between the landowner and the bondholder.

Hershey v. Cole, 130 Cal. App. 683.

The state acquires the property from the landowners by tax process, in the name of the district (*Anderson-Cottonwood v. Klukkert,* supra) for the amount of the delinquent assessment. A private purchaser could not buy this property at tax sale for less than the amount of the assessment. (Secs. 44, 47, *California Irrigation District Act.*) It would seem, therefore, that the state cannot rid itself of liability on the bonds otherwise than by the process of law by sale of the land to private owners, and of course it is established that such sale is made subject to the debt of the district. (*Provident v. Zumwalt,* supra.) Therefore, we contend that the state's consent to the bankruptcy proceeding amounts to repudiation of the state's own indebtedness, and that it cannot do this; that the bankruptcy power does not extend to the state in such a manner as to enable the state to repudiate its own debts. Here the state has become the owner of the land. It is also maker of the bonds. In a peculiar and

double sense, therefore, it is the debtor and it cannot, we maintain, repudiate its own debt. (Minority opinion in *Ashton v. Cameron County Water Improvement Dist. No. 1,* 298 U. S. 513.) Were there landowners in this district other than the state there might be a logical basis for the position that the state can consent to a bankruptcy proceeding which involves a contract between those landowners and the bondholders. But where the state has succeeded to the interest of the landowners, and becomes the landowner as well as the debtor, it does not seem that bankruptcy can intervene to cancel and repudiate the indebtedness.

In the third place, California Constitution, Art. XIII, Sec. 6, provides:

> "The power of taxation shall never be surrendered or suspended by any grant or contract to which the state shall be a party."

We contend that the state's consent violates this provision of the State Constitution.

In *Board of Commissioners of Wood County v. State* (Okla. 1926), 257 Pac. 778, 779, it was held that a statute providing that the lien of the state under a mortgage should be prior to the lien for taxes violated Section 5 of Article X of the State Constitution, which provided:

> "The power of taxation shall never be surrendered, suspended, or contracted away."

In *Nelson v. Pitts* (Okla. 1926), 259 Pac. 533, the same constitutional provision was applied, the Supreme Court declaring invalid a statute which pro-

vided that upon the sale of property the proceeds should be applied first to the payment of the special assessment liens.

The power of taxation is not limited by ability to pay.

> "In estimating the value of land, an assessor should take into consideration all of its elements or incidents, such as location, quality, condition, improvements, and use, which affect market value or would influence the mind of a purchaser. Also, the adaptability or availability of the land for a particular use may be considered in so far as it enhances the present actual value of the land. * * *." 61 C. J., pp. 643, 644, § 793.
>
> "Except in some jurisdictions, the rental or net income producing-capacity of real property which is rented or produces income is an important element to be considered in determining the actual or market value of the property for purposes of assessment, but it is not the only element to be considered, and in many instances the amount of rental received would be wholly misleading." Ibid., pp. 644, 645, § 794.

Here the court bases its finding of fairness solely upon the "ability to pay" theory. That the bonds were issued on an entirely different basis of security and taxation in these districts is not based upon "ability to pay". How can the bankruptcy court take a different standard than that provided by state law? May property which has value but no income escape taxation?

We also contend that Article I, Section 14 of the California Constitution which provides that the legislature has no power to take property of one person and give it to another nor to take it for a public use without compensation, prohibits the taking of these bonds and consenting to the bankruptcy procedure.

California also has a constitutional provision prohibiting the impairment of the obligation of contracts. Article I, Section 16. It seems to us that there is a fallacy in the line of thought suggested that because Congress has power under the bankruptcy clause to enact bankruptcy legislation and the state's consent does not violate the national constitutional provision against the impairment of the obligation, that the same holds true with respect to the state's constitution. The people of California had the right to write into their constitution a provision that in spite of the national bankruptcy act, the state cannot impair the obligation of a contract. Also it is fallacious, it seems to us, to say that this impairment is by the court, not by the state itself. To this our answer is that the California Constitution also prohibits the delegation of powers to a court other than those set up by the State constitution. Article VI, Section 1.

True, in the case of *Peoples State Bank v. Imperial Irrigation District,* 99 Cal. Dec. 317, 101 Pac. (2d) 466, the court holds the state can consent. This decision goes no further than to declare that in *U. S. v. Bekins,* 304 U.S. 27, it was held that the state could consent. In other words, it decides a question of federal law, not a question of state law.

Finally, having in mind the separability clause which is added to the amended Chapter IX, the Congress must have added that clause with a definite purpose in mind. We submit that if there is any sort of instrumentality or political subdivision of the state which is entitled to immunity, it must be the James Irrigation District. Its functions are exclusively governmental. The power to borrow money and to tax are essential powers of sovereignty. Any infringement of those powers must be in interference with sovereignty.

No sovereignty can give up a sovereign right and remain sovereign. It is to that extent less sovereign. If the provisions of Chapter IX apply to an instrumentality of the state, such as this district, it must involve the enlargement and extension of federal powers over the state. This the state is powerless to authorize.

Carter v. Carter Coal Co., 298 U.S. 238.

Given control of the states' borrowing and taxing powers, Congress will possess a power that might easily lead to their destruction. This court has not yet held that Congress has power to tax the bonds issued by these state instrumentalities nor their income. We affirm that such taxation does not extend to them even with the consent of the state, and we contend by way of analogy that to extend bankruptcy to the state and these bonds is to destroy the bonds Congress cannot tax.

CONCLUSION.

It is submitted that a writ of certiorari should be granted, the decree of the court below reversed and the proceeding directed to be dismissed.

Dated, Turlock, California,
January 6, 1941.

Respectfully submitted,
W. COBURN COOK,
Counsel for Petitioners.

Due service and receipt of a copy of the within is hereby admitted

this_____day of January, 1941.

_____

Counsel for Respondent.

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Statutes of the Extra Session of 1934, Chapter 4	16

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1940

No. 699

GILBERT MOODY, JAMES H. JORDAN and WALTER J. SELBY,
Petitioners,

vs.

JAMES IRRIGATION DISTRICT, Debtor,
Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

The above-named debtor acknowledges receipt of a copy of the petition for writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and the brief in support thereof, together with a copy of the record prepared by the Clerk of said Circuit

Court of Appeals, and respectfully submits this reply to said petition and to the brief in support thereof.

This was one of five cases argued together before the Circuit Court of Appeals for the Ninth Circuit in February of 1940, and decided by that Court after careful consideration September 5th. Petitions for rehearing were filed in all the cases and were all denied October 15th. Petitions for certiorari have been heretofore filed in this Court in two of these cases, and both were denied January 6, 1941. These cases were entitled in this Court

> *Pacific National Bank v. Merced Irrigation District,* No. 591,

hereinafter referred to as "the *Merced* case", and

> *Newhouse v. Corcoran Irrigation District,* No. 589,

hereinafter referred to as "the *Corcoran* case".

In deciding these five cases, the Circuit Court of Appeals relied upon and followed the decision of this Court in

> *United States v. Bekins,* 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137,

upholding the constitutionality of what was then designated Chapter X of the Bankruptcy Act, now designated as Chapter IX of that Act as revised by the act approved June 22, 1938. In that decision, this Court determined not only that the new addition to the Bankruptcy Act was constitutional, but that its provisions were applicable to the Lindsay-Strathmore Irrigation District, a district organized and existing under what is know as the California Irrigation District Act.

It appears from the findings of fact in this case (R. pp. 67 and 68) that James Irrigation District was organized and exists under the same act as the district involved in the *Bekins* case.

THE ESSENTIAL FACTS.

This case arises pursuant to the confirmation by the U. S. District Court for the Southern District of California of a plan of composition of the outstanding indebtedness of James Irrigation District, which was accepted by creditors holding more than 99 per cent of the outstanding warrants and more than 97 per cent of the outstanding bonds which constituted the indebtedness of the District. (R. p. 86.) These warrants and bonds were of the total face value of $1,016,954.75. (R. p. 79.) The text of the plan of composition and the pertinent facts about the District are set forth in the Findings of Fact and Conclusions of Law given in full in the Record, beginning at page 66.

ISSUES INVOLVED.

On pages 11 to 13 of the petition herein are set forth six questions and six reasons for granting the writ. These points, as they are further explained in the brief in support of the petition, will be considered as succinctly as possible in this reply.

The Petitioners for the writ are hereinafter referred to as "the Petitioners".

I. THE CREDITORS WERE PROPERLY CLASSIFIED AS OF ONE CLASS AND ENTITLED TO SHARE ALIKE IN THE AVAILABLE FUNDS UNDER THE PLAN OF COMPOSITION.

The first question presents the issue that the Court below did not properly classify the claims of creditors. The same contention was made as the fifth proposition in the *Merced* case and disposed of at pages 671 to 674 of Volume 114 of Federal Reporter, Second Series.

In its decision in this case (R. pp. 128 and 129), the Circuit Court of Appeals refers to the fact that the point was made in the *Merced* case "and there decided contrary to the contenders' position". The Appellants contended, however, that the facts in the *James* case were different from those in the *Merced* case, and after a statement of their position, the Circuit Court of Appeals said:

> "But we decided in the Merced case that due bond interest and principal does not become preferred claims when presented and registered as provided by Section 52 of the California Irrigation District Act. Had the District proceeded in its course as a solvent entity, the holders of overdue bonds and interest would have been paid in accordance with Section 61a of the California Irrigation District Act. But it did not and could not have so proceeded, and it resorted to the bankruptcy law for relief."

Emphasis is laid by the Petitioners here on the fact that they are the only creditors who ever presented any matured claims to the Treasurer of the District. In view of the insolvent condition of the District and the vast number of bonds and coupons which had ma-

tured and could not be paid, as shown by the Findings of Fact, most of the creditors deemed it an idle act to present their matured bonds and coupons to the Treasurer for payment. But Petitioners sought to gain a technical advantage by presenting certain of their bonds and coupons to the Treasurer and at least some of them were registered, as provided by Section 52 of the California Irrigation District Act, which, together with Section 61a of the same Act, is quoted in full in the margin on page 673 of 114 Fed. (2d).

The Petitioners state that the California law provides that the obligations of an irrigation district shall be paid "in the order of their presentation to the Treasurer after maturity", basing this statement on

Bates v. McHenry, 123 Cal. App. 81, 10 Pac. (2d) 1038.

That was a decision by the Third District Court of Appeal of California on an application for a writ of mandate to compel the Treasurer of Merced Irrigation District to pay certain matured coupons for which he had funds on hand. He had refused to pay the coupons on the ground that he did not have money enough to pay all then due, but the Appellate Court decided that Section 52 required the Treasurer to make payment in full of the matured coupons presented until the entire fund in his hands available for that purpose was exhausted, "and then to forthwith proceed to register any and all interest coupons on which payment is not made, if so demanded by the holder thereof". In its opinion the Court went on to say:

> "Thus absolute equity is meted out between the coupon holder who receives instant payment and the coupon holder whose payment is deferred."

This was explained by the fact that those who did not receive payment in cash would be compensated by receiving interest at the legal rate of 7 per cent per annum on the amount of their coupons.

The procedure for the payment of registered coupons was not an issue in the case. The Court said it was not necessary to set forth the method of payment further than to state that the registered coupons or bonds would follow the same procedure as was provided in Section 61a of the Act for registered warrants and the Court followed this with the remark that the holders thereof were entitled to payment "immediately upon funds coming into the hands of the Treasurer of the District available for such purpose and in the order in which they were registered".

Under the circumstances of that case, this remark was clearly dictum and a careful reading of Section 61a shows that the Court did not accurately summarize the provisions of that section, which clearly provides, with reference to warrants, that whenever there is sufficient money in the treasury to pay *all* the warrants that have been registered, or, if the Board so orders, all such warrants presented for payment prior to a certain date, the Treasurer shall give notice and "upon the presentation of *any* warrant entitled to payment under the terms of such notice, the Treasurer shall pay it, together with interest thereon".

The obvious purpose of both Section 52 and Section 61a was to provide for equality of treatment to the creditors of an irrigation district in case of a temporary default. There was no application for hearing before the State Supreme Court in that case, but in several cases coming before the Supreme Court in later years the dictum in *Bates v. McHenry* to the effect that registered coupons should be paid "in the order in which they were registered", has been quoted, although in none of these cases was the order of payment of registered coupons an issue to be decided. As a matter of fact, in all of these cases the State Supreme Court cited *Bates v. McHenry* to show that no bondholder was entitled to preferential treatment.

Petitioners lay stress on the decision in

Provident Land Corpn. v. Zumwalt, 12 Cal. (2d) 365, 85 Pac. (2d) 116.

That was an action by a bondholder to set aside the purchase by Provident Irrigation District of some of its unmatured bonds which had been bought with $10,000 taken from the General Fund of the district under a declaration of the Board that the money was "surplus funds". The decision of the Supreme Court was on appeal from a judgment by default following the sustaining of a general demurrer to the complaint. Therefore, the only issue in the case was whether the purchase of the bonds under the circumstances alleged in the complaint was valid. The Court said that if a surplus did exist over and above the operating needs of the district, it should not be given to junior bondholders in preference to those with prior claims, "but

should be paid on past due bonds and coupons in the order of their registration".

To understand this paraphrase of the dictum in

Bates v. McHenry (supra),

we must refer to the facts as stated in the complaint and summarized in the Court's opinion, from which it appears that Provident Irrigation District had an area of some 22,805 acres and that while it was in serious financial difficulties, only 10,000 acres had been taken by the district under tax deed. Therefore, the Court could not conclude from the complaint that the district was hopelessly insolvent. Further on in the opinion, the Court supposes a case where "the assessment method has disappeared as a means of collecting revenue" and it refers to its decision in

Kerr Glass Mfg. Corpn. v. San Buenaventura, 7 Cal. (2d) 701, 62 Pac. (2d) 583,

"where we recognized the justice of applying equitable principles to the payment of bondholders in unusual circumstances, notwithstanding the fact that express provisions of the statute stood in the way".

It is not surprising, therefore, to find that when the construction of Section 52 of the California Irrigation District Act came again before the Third District Court of Appeal in

Clough v. Baber, 38 Cal. App. (2d) 50, 100 Pac. (2d) 519,

in a case in which it was admitted that the district was insolvent and that its taxing power had been exhausted, and that to construe the section literally would no longer mete out "absolute equity" to the

bondholders, the Court determined that the Petitioner was "not entitled to payment in full of his five registered bonds as a preference, but the available funds should be apportioned pro rata among the holders of all valid claims". Counsel for Petitioners here was counsel for certain intervenors in that case and application was made to the Supreme Court of the State for a hearing after a decision by the Third District Court of Appeal, but the application was denied although the importance of the issue involved was forcefully presented to the Supreme Court.

We therefore have a decision by the same Court which decided the case of

Bates v. McHenry (supra),

holding that when an irrigation district is insolvent and the literal application of Section 52 can no longer mete out "absolute equity" to the bondholders, the State Courts must apply equitable principles to the distribution of the available funds among those entitled to them. Much more then must a bankruptcy Court disregard a legal claim to technical preference and make its classification of creditors in the light of the obvious purpose of the law that all bondholders should be treated alike.

Chapter IX of the Bankruptcy Act provides that a plan of composition cannot be confirmed unless it is found to be "fair, equitable and for the best interests of the creditors and does not discriminate unfairly in favor of or against any creditor or class of creditors". The Petitioners here base their plea for a writ of certiorari on the express ground that the District's

plan of composition *does not discriminate in their favor.*

This naive contention becomes the more absurd in the light of the conditions which forced the District into the Bankruptcy Court. In the opinion of the Circuit Court of Appeals (R. p. 127) its taxing power was described as having become practically exhausted, leaving the bonded indebtedness outstanding, "the clearest possible case of insolvency", and the following from that Court's opinion (R. p. 133) is equally significant:

> "It must be remembered that this is not a procedure in liquidation and the principles to be applied must differ somewhat from such proceedings. In liquidation it is perfectly evident that the creditors would get almost nothing."

II. PETITIONERS' SECOND POINT IS MADE HERE FOR THE FIRST TIME.

The second point made by the Petitioners is that, because the District owns practically all the land within its boundaries, the Plan of Composition should have offered the creditors not only the full amount of the loan authorized by the Reconstruction Finance Corporation, but also the land which the District owned.

It is a sufficient answer to this contention that it is made for the first time in this Court. The Record will be searched in vain for any indication that any such idea was even suggested in either of the Courts below.

There is no showing that the bondholders had any desire or fitness to become landowners. Had the land been given to them, it would have become subject to taxation to pay maturing interest and principal of the bonds issued to evidence the loan, and one witness testified without contradiction (R. p. 62) that if all the land in the District were free of any bonded indebtedness it would be worth "not more than $250,000", or a little less than the amount of the loan. It would therefore have been backhanded generosity to have offered the land to the bondholders and thus made them subject to taxation to repay the loan, which H. E. Vogel, a member of the California Districts Securities Commission, testified (R. p. 64) "was well up to the limit of the ability of the lands in the District to meet".

Petitioners argue, however, that under the law of California, the loan could not exceed 60 per cent of the value of the works and water rights of the district plus the value of the land within its boundaries, and they point to a report of the California Districts Securities Commission (R. p. 49) estimating the value of the works and water rights at more than $1,000,000, and the value of the lands at in excess of $960,000.

The same legal limitation prevailed when the original bonds were issued, but it did not prevent the issuance of bonds in the amount of $1,000,000, which the District found it impossible to pay. The proceeds of the old bonds were all expended for the works and water rights of the District, which is obviously the basis of the Commission's "estimate" that they were

worth in excess of the amount of the bond issue, and it appears (R. p. 19) that the total amount of the District's assessment roll at the time of the hearing was $967,450, which accounts for the Commission's estimate of over $960,000 as the value of the land. These figures cannot impair the sworn testimony of experts, who showed intimate knowledge of the District, that the loan was substantially all that the District could be expected to pay. If Petitioners had really thought the land was actually worth more than the amount of the loan, they had full opportunity to offer testimony to that effect, but none was forthcoming.

Furthermore, the works and water rights of the District are not assets available to the bondholders, who are limited to the lands in the District as the source of revenue from which their obligations are to be paid. This was determined in the *Corcoran* case (supra) in which certiorari was denied by this Court January 6th of this year.

Furthermore, an act authorizing an irrigation district to mortgage its properties as additional security for bonds was declared unconstitutional in

Merchants National Bank v. Escondido Ir. Dist.,
144 Cal. 329, 77 Pac. 937.

III. THIRD POINT HAS ALREADY BEEN DECIDED AGAINST THE PETITIONERS.

The third point is based on the contention that the Supreme Court of California has recently determined that the functions of an irrigation district are ex-

clusively governmental and therefore Chapter IX of the Bankruptcy Act cannot be applied to such a district.

The point was held to be without merit by that Court in the recent case of

People's State Bank v. Imperial Ir. Dist., 15 Cal. (2d) 397, 101 Pac. (2d) 466,

in which it was pointed out that the governmental nature of irrigation districts had been established by Court decisions long before the decision of this Court in

United States v. Bekins (supra).

The point was also made in the *Merced* case at page 662 of 114 Fed. (2d) and rejected by the Circuit Court of Appeals.

IV. THE STATE HAS NO LIABILITY FOR DISTRICT BONDS.

The fourth point of the Petitioners is based on the fact that James Irrigation District had acquired by delinquent tax proceedings title to practically all the land in the District and had further acquired the State's title to the same property, which had also been sold to the State for delinquent county taxes. This was in pursuance of the requirement of special condition No. 4 of the resolution adopted by the Reconstruction Finance Corporation authorizing the loan to the District, that the lands within the District should be relieved of all delinquent taxes other than irrigation district assessments. (R. p. 24.)

Petitioners, at page 32 of their brief, cite

Anderson-Cottonwood Ir. Dist. v. Klukkert, 13 Cal. (2d) 191, 88 Pac. (2d) 685,

to the effect that the property of an irrigation district is really the property of the State, and therefore is not subject to local taxation as long as the title is held by the District. It is, therefore, argued that the State has become the creditor and cannot give its consent to the bankruptcy plan for its own benefit.

An irrigation district is an agency of the State, but the State does not thereby become responsible for the indebtedness of such a district. It is simply not true, as stated in Question 4 on page 11 of the petition herein, that "the bonds which are the subject of the composition plan are issued by the State". They are certified by the State Controller as legal investments for trust funds and banks, but they are issued by the District on authorization by a vote of the electors of the District. It has never been held that the District's bonds are bonds of the State or that the State has any liability with regard to them. The ownership of tax-deeded land by the District is only temporary and James District was expressly required by condition No. 1 of the resolution of the Reconstruction Finance (R. p. 23) to return substantially all of the irrigated lands to private ownership.

It is shown in the Findings (R. p. 78) that nearly all the land owned by the District has been sold on contract to private purchasers, who have thus become the equitable owners of the land, and this destroys the

argument that the State is the real owner of the land and cannot consent to the bankruptcy proceedings.

Petitioners, however, at pages 31 to 33 of their brief, advance the novel theory that the District should have held the land in public ownership and paid no taxes, but rented it out and given the rentals to the bondholders. Of course, under this plan no loan could have been obtained, for it was one of the conditions of the loan that the land should be restored to private ownership, and it would be absurd to suppose that an area of over 24,000 acres could be permanently withdrawn from the local tax rolls, and continue to enjoy the advantages of roads, schools and police protection at the expense of other taxpayers of the county.

Furthermore, this point, like the point that the plan of composition should have offered the bondholders both the land and the loan, is presented here for the first time. It is an obvious afterthought and indicates that the Petitioners are not quite sure whether they want to own the land or want the District to own it and keep it off the County tax rolls and give them the rentals from it. Either scheme would have been impracticable.

V. THE STATE'S CONSENT TO THE FILING OF PETITIONS BY DISTRICTS UNDER THE BANKRUPTCY ACT IS NOT FORBIDDEN BY THE STATE CONSTITUTION.

This Court held in the *Bekins* case that if the consent of the State to the filing of a petition in the

bankruptcy Court by Lindsay-Strathmore Irrigation District was necessary, such consent had been given by Chapter 4 of the Statutes of the Extra Session of 1934. The fifth point in the petition for certiorari herein is that the State is prohibited by its own constitution from consenting to bankruptcy relief, the contention being based on constitutional provisions against the surrender of taxing power, impairment of contracts, delegation of judicial authorities and taking private property without just compensation.

The same points were made by the same counsel appearing for the Petitioners here before the Supreme Court of California in

People's State Bank v. Imperial Ir. Dist. (supra),

in an action for an injunction to prohibit Imperial Irrigation District from instituting proceedings in the U. S. District Court for the confirmation of a plan of composition with its creditors. The State Court denied the injunction and declared that it was in thorough accord with the views expressed by this Court in the *Bekins* case "particularly in respect to its conclusion as to the constitutionality of the statute of our own State".

The State Supreme Court then summarized the argument for the Plaintiff on constitutional grounds and said:

> "This same argument was made before the Supreme Court of the United States in the Bekins case, and we understand by the same counsel now representing the appellants in the

instant case. Some of them were answered by that court and others were evidently not thought of sufficient importance to require an answer. Undoubtedly the Court considered each and every one of them and found that none of them was meritorious."

The State Supreme Court also referred to the fact that Chapter 4 of the Statutes of the Extra Session of 1934 was repealed in 1939, but with an express proviso that its repeal should not impair any action or proceeding commenced while that chapter was in effect, and in the same act it was provided that the State consented to the application of Sections 81 to 84 of the United States Bankruptcy Act "to the taxing agencies and instrumentalities of this State". Therefore, the Court concluded that, whichever of the two statutes might be applicable to the proceeding then pending, the State had given its consent to the filing of the petition.

The same argument was also made and rejected in the *Merced* case (114 Fed. (2d) at p. 665).

VI. THE BONDS PURCHASED BY R. F. C. ARE STILL OUTSTANDING.

The sixth point of the petition is based on the fact that over 90 per cent of the bonds of James Irrigation District were held at the time of the filing of the plan of composition by one corporation, and afterwards purchased by the Reconstruction Finance Corporation,

from which the Petitioners argue that the plan has to that extent been executed. The old bonds, however, are still held under a contract with the District, which is set forth in the Record beginning at page 26, and provides (R. pp. 27 and 28) "that R.F.C. may, in its discretion, keep any part of said indebtedness alive for the sole purpose of maintaining a parity between itself and the holders of indebtedness of said borrower who have not agreed to enter into the refinancing scheme of said borrower, or for any other purpose".

A similar provision in such a contract was considered by the Circuit Court of Appeals for the Eighth Circuit in

Luehrmann v. Drainage District No. 7, 104 Fed. (2d) 696,

and it was held that the Reconstruction Finance Corporation was a creditor affected by the plan of composition of the drainage district in the full amount of the bonds so purchased. A writ of certiorari was denied in that case in this Court November 6, 1939, under the title

Haverstick v. Drainage District No. 7, 308 U. S. 604,

and it is therefore settled that under such circumstances the Reconstruction Finance Corporation, as the holder of old bonds, is a creditor of the district and that the indebtedness represented by the old bonds has not been settled pending the completion of the district's refinancing plan.

In view of the fact that no proper showing has been made of any reason why a writ of certiorari should

issue, and in view of the unanimity of the decisions of various circuit courts in upholding the new Chapter IX of the Bankruptcy Act, James Irrigation District respectfully prays that the petition for the writ be denied.

Dated, Stockton, California,
February 3, 1941.

A. L. COWELL,
Counsel for Respondent.